

# Daily Journal

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## Sorting Out a Liability Mess

### FOCUS COLUMN

*By Stephen N. Goldberg*

In *State of California v. Allstate Insurance Company*, 2009 DJDAR 3425 (March 9, 2009), the California Supreme Court reversed a trial court's grant of summary judgment for a handful of insurance carriers who refused to defend the state against and indemnify it for liabilities arising from an infamous toxic waste site - the Stringfellow Acid Pits. Neither this opinion, nor another in the same matter handed down by the 4th Appellate District in January, finally resolves the state's claims. Instead, both courts sent two groups of insurance carriers back to the trial court for further proceedings. In both, the insurers lost significant battles but will no doubt continue the fight on yet another day.

The Stringfellow Acid Pits began operations in 1956, six years before Rachel Carson's "Silent Spring" presaged the modern environmental movement. More than 30 million gallons of industrial waste were deposited there between its first day of operation and its closure by state authorities in 1972. Eight years later, the federal government enacted the Comprehensive Environmental Response, Compensation and Liability Act to clean up industrial pollution and require potentially responsible parties to reimburse the government for its efforts.

Stringfellow was the first major industrial site placed on the Environmental Protection Agency's National Priority "Superfund" List in 1982. The following year, the Department of Justice, on behalf of the EPA, joined with the state to file a federal court suit against many companies that had disposed of toxic waste at the site. Those companies cross-claimed against the state, asserting that it was liable for the entirety of the government's investigation and remediation expenses. Sixteen years later, in 1998, the federal court held the state responsible for all contamination at the site based on findings that it had been negligent in its selection and construction as well as in its failure to prevent, investigate, and remediate pollution there.

While the state, the EPA and waste generation and disposal companies were fighting it out in federal court, the state asked its insurers to defend and indemnify it against the waste companies' cross-claims. The insurers denied coverage for those claims and the state brought

suit in state court in 1993.

*Allstate* should not be confused with the other recent decision involving the state's attempt to obtain insurance coverage for its liabilities at the same Superfund site in the same litigation, *State of California v. Continental Insurance Co.*, 2009 DJDAR 755 (4th App Dist, Jan. 5 2009). *Continental* rejected the arguments of a different group of the state's insurers, holding that a policyholder is entitled to "stack" (i.e., add together) the limits of insurance policies in effect over multiple years that apply to a single loss spanning those years. *Continental* also sets forth the analytical framework for determining the number of occurrences that would determine how the carriers' coverage limits would be applied.

*Allstate* resolves different issues than litigated in *Continental*. The two decisions together are important not simply for the road map they lay out for lawyers making insurance claims and carriers adjusting them but also as an historic record of the development of two relatively recent and important areas of law - the law governing the protection of the environment from toxic substances and the obligations of insurers to provide coverage for environmental liabilities. Together, these two decisions resolve numerous and complex bodies of jurisprudence.

The policy provision at issue in *Allstate* was the "qualified" pollution exclusion contained in comprehensive general liability policies from 1970 through the mid-1980s. This exclusion barred coverage for third-party property damage liability "arising out of the discharge, dispersal, release or escape of ... contaminants or pollutants into or upon land ... [unless] such discharge [etc.] is sudden and accidental." The interpretation and application of this exclusion to the state's liabilities in the underlying action will determine the existence of coverage for liabilities projected to be as much as half a billion dollars.

The trial court granted summary judgment in favor of the insurers. On appeal, the state asked the Supreme Court to define the liability-causing events that fall within the "sudden and accidental" exception to the qualified pollution exclusion. If, as the insurers contended, the waste generators' deliberate deposits into Stringfellow's containment ponds were "releases" subject of the exclusion, coverage would be barred because such deposits were neither "sudden" nor "accidental." If, however, the court adopted the state's theory - that the relevant releases were dispersals of pollutants *out* of the ponds and into the soil and groundwater - at least two liability-creating events would potentially fall within the scope of the "sudden and accidental" exception to the exclusion.

In resolving this issue, the court reminded the parties that coverage *creating* exceptions to exclusions must be broadly construed in favor of the insured. That being the case, the court focused its analysis on the type of liabilities for which the insured reasonably expected to be covered.

Applying this precept, the Supreme Court explained that the state's liability was "based on its having sited, designed, built, and operated the Stringfellow facility in such a negligent manner as to allow hazardous chemicals to escape from the evaporation ponds ... into the surrounding environment. The state was *not* held liable [by the federal court] for polluting *the evaporation*

*ponds*, but for polluting the land and groundwater *outside the ponds*" (emphasis in original).

The court went on to determine whether overflows from two massive rainstorms in 1969 and 1978 would fall within the exception to the exclusion. The 1969 overflows were surely "sudden" and "accidental." During the 1978 storm, however, the state *intentionally* released contaminated waters to avoid dam breakage in an effort to prevent potentially catastrophic damage to the surrounding communities.

In one of the more significant insurance coverage rulings to come down from the Supreme Court in many years, the court held that property damage caused by intentional prophylactic releases were *not* barred from coverage so long as the potential damage were intended to avoid damage and resulting liability that would have been covered if permitted to occur. Were it otherwise, reasoned the court, insureds would be discouraged from avoiding or mitigating potentially covered losses. As the court stressed, "when an insured takes out a policy providing coverage for property damage liability, '[i]t would seem strangely incongruous to him, as it does to us, that his policy would cover him for damages to tangible property destroyed through his negligence in allowing a fire to escape but not for the sums incurred in mitigating such damages by suppressing the fire.'" The scope of the court's statements makes this ruling applicable to all third-party liability policies, which almost universally seek to exclude coverage for liabilities for intentionally caused injuries.

In regard to the 1978 intentional releases, the Supreme Court sent the matter back to the trial court not to determine whether those releases could be considered "accidental," but whether the discharges the state was attempting to prevent would have been accidental had they been allowed to occur. As the court concluded, "to the extent the conditions in March 1978 threatened a 'sudden and accidental' release of wastes from the Stringfellow site, the qualified pollution exclusion does not bar coverage for liability arising from the State's intentional releases performed to prevent such a greater accidental release." The Supreme Court next addressed an issue that has been a thorn in the side of policyholders since the Court of Appeal decided *Golden Eagle Insurance Co. v. Associated International Insurance Co.*, 85 Cal.App.4th 1300 (2001). In *Golden Eagle*, the appellate court required policyholders to prove a direct causal relationship between identifiable "sudden and accidental" releases and specific property damage suffered as a result.

During discovery in the *Allstate* litigation, the state had admitted its inability to distinguish between property damage caused by the 1969 and 1978 releases, on the one hand, and that caused by the gradual leakage of wastes over the entirety of the site's history, on the other. Nor could the state differentiate among the work performed to remedy property damage caused by any of the various sets of releases. As a result, the trial court, relying on *Golden Eagle*, granted summary judgment for the insurers and deprived the state from obtaining coverage for *any* of its liabilities because of its inability to distinguish the liabilities caused by gradual releases from the liabilities caused by sudden and accidental releases. *Golden Eagle*, however, ignored a controlling 1973 Supreme Court opinion, *State Farm v. Partridge*, 10 Cal.3d 94 (1973), that also dealt with covered and uncovered sources of liability.

The Supreme Court reversed the trial court, reaffirming the vitality of *Partridge* and disapproving *Golden Eagle*. So long as the state's liability was based, in part, on covered releases that "were substantial factors in causing [indivisible] contamination of soils and groundwater," the insurers were required to indemnify the state for the entire loss. In other words, the coverage follows the liability, as the policy terms themselves state.

As the court explained, "If the insured's nonexcluded negligence 'suffices, in itself, to render him fully liable for the resulting injuries' or property damage ... the insurer is obligated to indemnify the policyholder even if other, excluded causes contributed to the injury or property damage."

The Stringfellow liability and coverage lawsuits present the paradigmatic liability for which insureds purchase comprehensive (now "commercial") general liability policies - expensive, protracted, and potentially fatal claims that no one did - or could have - anticipated. The overarching, practical lesson to be drawn from coverage cases such as *Allstate* and *Continental* is that independent coverage counsel who are not beholden to insurance companies must be involved at all stages of the proceedings to ensure that the liability rulings are shaped with coverage in mind. The Supreme Court in *Allstate* stated the guiding principle simply and without fanfare: "While coverage under ... third party insurance is a matter of contract, [its] contractual scope ... as reflected in the policy language, depends on the tort law source of the insured's liability."

Just as tort law expands and takes on new forms that mirror developing economic, social, political and cultural norms, so must liability policies be broadly construed to protect the insured's reasonable expectations that all forms of non-willful tort liabilities will be covered. The Supreme Court recognized this need and gently reminded the insurers of the interrelationship between the two bodies of law.

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